October 24, 2014

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Re: Your Request for Informal Assistance
Our File No. I-14-130

Dear Ms. Erlingsson :

This letter responds to your request for advice regarding the lobbying provisions of the Political Reform Act (the "Act").[1] Because you are asking general questions, we are treating your request as one for informal assistance.[2]

FACTS

You and your firm represent entities, including banks, private equity firms, and investment management firms that may be involved in activities that qualify them as "placement agents" under the Act. Your questions focus on the definition of placement agent and the exceptions thereto as applied generally, and are not based on the facts of any particular client or situation.

ANALYSIS

The Act regulates the activities of lobbyists, lobbying firms, and lobbyist employers. (Sections 86100 et seq.) These terms are defined in the Act as individuals or entities that make or receive payments for the purpose of influencing legislative or administrative action. (Sections 82038.5, 82039, 82039.5.) "Placement agents" are included in the definition of lobbyist when influencing an administrative action on behalf of an external manager. (Section 82039(a)(2.)

[1] The Political Reform Act is contained in Government Code Sections 81000 through 91014. All statutory references are to the Government Code, unless otherwise indicated. The regulations of the Fair Political Practices Commission are contained in Sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to Title 2, Division 6 of the California Code of Regulations, unless otherwise indicated.

[2] Informal assistance does not provide the requestor with the immunity provided by an opinion or formal written advice. (Section 83114; Regulation 18329(c)(3).)

With regard to placement agents, "administrative action" includes "the decision by any state agency to enter into a contract to invest state public retirement system assets on behalf of a state public retirement system." (Section 82002(a)(2).) In pertinent part, the Act further provides:

> (a) "Placement agent" means an individual directly or indirectly hired, engaged, or retained by, or serving for the benefit of or on behalf of, an external manager or an investment fund managed by an external manager, *and who acts or has acted for compensation as a finder, solicitor, marketer, consultant, broker, or other intermediary in connection with the offer or sale to a state public retirement system* in California or an investment vehicle either of the following:
>
> (1) In the case of an external manager within the meaning of [Section 82025.3(a)(1)], the investment management services of the external manager.
>
> (2) In the a case of an external manager within the meaning of [Section 82025.3(a)(2)], an ownership interest in an investment fund managed by the external manager.
>
> (b) Notwithstanding subdivision (a), an individual who is an employee, officer, director, equityholder, partner, member, or trustee of an external manager and who spends one - third or more of his or her time, during a calendar year, managing the securities or assets owned, controlled, invested, or held by the external manager is not a placement agent.

(Section 82047.3, emphasis added.)

1. *Does an attorney who provides counsel to an external manager on the contractual issues arising from the offer or sale of a portfolio or asset qualify as a placement agent?*

Your firm provides counsel regarding contractual issues arising from the offer or sale of portfolios or assets to California public retirement systems. In some cases, the attorney communicates directly with the public retirement system and in other cases the attorney communicates only with his or her client as necessary regarding the contracts, and the client relays that information to the public retirement system.

The definition of placement agent under the Act is broad, with limited exceptions. Given the Legislature's goal of curtailing certain abuses, a broad reading of the definition of placement agent helps accomplish that goal by ensuring that all of those engaging in placement agent services comply with registration and disclosure requirements. The Legislature explained that the purpose of including placement agents within the definition of lobbyist under the Act was to expand upon and codify CalPERS's and CalSTRS's earlier-adopted policies regarding transparency. In 2009, CalPERS adopted a policy for disclosure of fees paid to external

managers and placement agents that would "ensure that CalPERS's investment decisions are consistent with investment policy and fiduciary responsibilities" and to "help prevent impropriety and the appearance of impropriety in CalPERS's decision-making process." (See Assembly Bill analysis, AB 1743, Third Reading.)

CalPERS explained that to address improper influence over CalPERS board members and employees by placement agents, and to eliminate the multi-million dollar fees placement agents were accepting, full disclosure of the finances and other activities of placement agents would be necessary. Additionally, by considering placement agents "lobbyists" under the Act, placement agents would be subject to strict gift limits, contribution limits, and a ban on contingency fees. CalPERS compared placement agents to lobbyists: "those who try to influence legislation and regulatory actions or secure government contracts." (Concurrence in Senate Amendments, Bill Analysis AB 1743, August 30, 2010.) The bill analysis further quoted CalPERS as saying, "Like lobbyists, placement agents attempt to influence the decisions of public officials." (*Id*.)

Given that the purpose of requiring placement agents to register as lobbyists is to increase transparency of those who "attempt to influence the decisions of public officials," that purpose is furthered by requiring disclosure from those people who are actually soliciting public retirement systems. Looking at the characterization of placement agents as a whole, it appears the Legislature intended to cover those people who are *marketing* to a public retirement system.

The attorneys who represent external managers are not making a solicitation, offering an investment fund or management service for sale. The attorneys, per our understanding, consult with the external manager and/or the public retirement system regarding a contract for the offer that the placement agent has already pitched or completed.

A placement agent is hired directly or indirectly by an external manager or investment fund and acts as a finder, solicitor, marketer, consultant, broker, or other intermediary in connection with an offer or sale of investment management services or an ownership interest in an investment fund. The Act's definition of placement agent includes outside third party intermediaries and in-house sales and marketing personnel.

You have specifically asked whether the following tasks that an attorney undertakes would meet the definition of "placement agent" and require the attorney to register as a lobbyist:

- Drafting and reviewing contract language;
- Negotiating contracts in connection with an investment;
- Providing tax advice related to investment contracts;
- Providing political law compliance services to the external manager company on state and local lobbying laws, such as the Act.

The listed activities are those that are expected of an attorney providing advice and counsel to his or her client. The legislative history makes clear that the class of persons who were intended to be covered as "placement agents" are those who attempt to influence an administrative action. (See Bill Analysis, Assembly Concurrence in Senate Amendments, AB 1743, June 2, 2010.) The Act defines administrative action, with regard to placement agents, as "the decision by any state agency to enter into a contract to invest state public retirement system assets on behalf of a state public retirement system." (Section 82002(a)(2).) While the attorney *is* acting on behalf of the external manager regarding the offer or sale of an interest in an investment fund or of investment management services, the attorney is not attempting to influence a decision. Our understanding of your facts is that the attorney is hired by the external manager to provide legal services, including tax advice and real estate expertise, concerning a particular investment fund or portfolio of assets. The attorney is not hired by the external manager to act as a finder of investors or to market the fund to a state public retirement system. As noted above, the attorneys consult with the external manager and/or the public retirement system about a contract for the offer that the placement agency has already pitched or completed.

In these circumstances, the attorney is not a placement agent under the Act, but is simply providing legal advice and services that are of a traditional legal nature. We caution, however, that the attorney could be considered a placement agent if the attorney represents himself or herself as promoting a product or service on behalf of an external manager or is paid by an external manager to market an investment opportunity or investment services to a California public retirement system. In such a case, the attorney's services would likely come within the definition of placement agent.

2. *What specific activities would be considered "managing" the securities or assets owned, controlled, invested, or held by the external manager for purposes of the "one-third exception"?*

The exception for employees, officers, directors, equityholders, partners, members, or trustees of the external manager allows for those people who are not primarily making offers or sales to public retirement systems to perform their job duties without being subject to lobbyist registration requirements. This includes the firm principals or employees who direct the purchase or sale of investments. It also allows such people to offer support to the placement agents and other decision-makers without themselves becoming placement agents. The statute exempts from the definition of placement agent a person "who spends one-third or more of his or her time, during a calendar year, managing the securities or assets owned, controlled, invested, or held by the external manager." (Section 82047.3(b).)

Generally, exceptions to a statutory rule are "construed narrowly to cover only situations that are within the words and reason of the exception." (See *McAllister v. California Coastal Com*. (2008) 169 Cal. App. 4th 912, 934-935, internal quotations omitted.) We therefore read the one-third exception narrowly and strictly when ascertaining its meaning.

The one-third exception was included as part of the original bill, AB 1743, and was unchanged by the "clean-up bill," SB 398. SB 398 eliminated the confusion caused by the broad definitions, particularly of "external manager," that seemed to encompass all broker-dealers who had business with a public retirement system. This was not the intent of the original bill and the Legislature changed the definition to reflect their true intent.

In addition to the statutory exclusion of certain classes of broker-dealers, the Commission has also approved a regulation that excepts certain experts from the placement agent definition. During the regulatory process, with much commentary from both representatives for placement agents and representatives from state public retirement systems, the Commission adopted a narrow exception for situations where a registered placement agent meets with a state public retirement system and brings along a technical expert. (Regulation 18239(a)(3).)[3] The exception provides that an individual does not become a placement agent "solely as a result of communicating with a state public retirement system representative provided that the individual, or his or her organization, is present only to provide additional substantive information and would not otherwise qualify as a placement agent." (*Ibid.*)

Together, these two exceptions highlight that those people who are working for an external manager (or in conjunction with a placement agent) who provide technical knowledge or specific financial expertise are not *marketing* and are therefore not placement agents. The definition of placement agent does not include broker-dealers who provide routine trading and sales in a brokerage firm while servicing a state public retirement account. Nor does it include financial experts who a placement agent calls upon to share his or her expertise with a client. As an example, once a placement agent concludes a sale of an investment fund or the services of an external manager, the state public retirement system might want to discuss a particular investment, including information about its performance or returns. The person that the state public retirement system would want to contact is the financial expert, not the placement agent who marketed the deal. Such a discussion call does not make the financial expert a marketer.

These exceptions, along with the legislative history and the language of the two bills, strongly suggest that the "one-third exception" was intended to exclude from lobbyist registration the types of people who are performing higher-level tasks and providing a greater financial expertise. These are the people who are actively managing securities or assets and spend a great percentage of their time doing so. We note that the exception does not simply apply to "investment managers," but to those individuals who spend their time *managing* securities or assets.

When looking at the activities of an "employee, officer, director, equityholder, partner, member, or trustee of an external manager," we think the best view to determine what qualifies as "time managing the securities or assets owned" is to envision two main categories. (Section 82047.3(b).) In the first are the hands-on activities that *directly relate* to overseeing an investment fund's performance and investment strategies. In the second are other management

[3] The Commission adopted the regulation at the September, 2013 Commission hearing. Staff memorandum and YouTube video of the hearing are available at: http://fppc.ca.gov/agenda.php?id=516

responsibilities such as hiring, supervising, or simply participating in the firm's operations, that, although they facilitate the securities management aspect of the position, they are not directly related to it.

Based upon these categories, we believe the following activities qualify as part of the duties of "managing securities or assets" and should be calculated within the one-third figure:

- Regularly meeting with the investment staff to discuss firm strategies, including potential acquisitions of target companies and liquidity events (e.g., sales of portfolio companies and dividend recapitalizations);
- Developing ongoing investment management strategies;
- Preparing and reporting on the analysis of investments and investment strategies;
- Monitoring financial or operational performance of investments to ensure portfolios meet risk goals.

In contrast to the above, we believe the following activities would not qualify for the on-third calculation:

- Reading financial briefings and related materials;
- Overseeing the legal negotiations and related activity required to close investment deals;
- Handling business and legal issues involving particular investment assets or properties;
- Ensuring and overseeing regulatory compliance;
- Evaluating, training and hiring staff as needed;
- Maintaining an internal database of information on the limited partners of the investment manager;
- Performing the general operations work of the investment manager.

3. *After a state public retirement system awards a contract for investment management services to an external manager, are the employees and attorneys*[4] *of the external manager considered to be "placement agents" when they provide services under the contract?*

As noted above, the definition of "placement agent" is broad and is intended to ensure appropriate disclosure from those who work on behalf of or for the benefit of an external manager "in connection with the offer or sale to a public retirement system in California or an investment vehicle" that is either investment management services or an ownership interest in an investment fund. (See Section 82047.3(a).) To accomplish this purpose, we must look to the specifics of the surrounding circumstances to determine to whom the definition applies.

In the first instance, those people who are actually making the sale or offering to sell an ownership interest in an investment fund or services of an external manager and who have contact with a public retirement system for this purpose on behalf of an external manager are placement agents. In enacting AB 1743, which included definitions for placement agent and external manager, the Legislature intended to obtain broad disclosure to counter explicit fraudulent acts and to prohibit contingency fees in some cases. CalPERS and CalSTRS, the largest public retirement systems in California, have a vested interest in maintaining the integrity of their investment funds. (Senate Rules Committee Bill Analysis, Third Reading, August 2010.) After it came to light that some placement agents were receiving multi-million dollar fees in connection with public investments, both of these entities adopted sweeping regulatory changes. (*Id*.) After the changes, all external managers are required to disclose any third-party relationships with persons (placement agents) who assist with the solicitation of CalPERS or CalSTRS, and any fees paid. (*Id*.) Those retirement systems took the additional step of not paying any placement agent fees, leaving the fee arrangement between the external manager and the placement agent. (*Id*.)

CalPERS and CalSTRS adopted these policies to create transparency and to protect and preserve the public's (and financial regulators') trust regarding their decision-making, and ensuring it is free from improper influence. It was after CalPERS and CalSTRS adopted their new ethical guidelines and regulations that the Legislature took action on its own to create additional oversight. The bill, AB 1743, treats placement agents as lobbyists so that there would be a public record of the placement agent with the Secretary of State's office and so that the Commission would provide advice and enforcement to facilitate the laws. By reading the statutes AB 1743 added broadly, the policy principals that CalPERS and CalSTRS set into motion and that the Legislature then expanded upon and codified are effectuated.[5]

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[4] See Question 1, above, for a discussion regarding attorneys.

[5] See generally, CalPERS's transparency policy and its relationships with placement agents in Cal. Code. Regs., tit. 2, § 559, available at: https://www.calpers.ca.gov/eip-docs/investments/policies/ethics/disclosure-placement-agent-fees.pdf.

Given the concern regarding the influence over decision-makers at California public retirement systems, the Legislature's focus seems to have been on those people who have the *opportunity to exert influence*. Those members of the external manager's staff who are assisting with the solicitation, providing investment information and marketing skills, but who do not have access to public retirement system board members and employees, do not have the opportunity to exert influence over the public retirement system's decisions. Additionally, the Commission approved a limited exception, discussed above, that allows the placement agent to bring to meetings with public retirement systems an expert to provide technical knowledge. This person does not register as a placement agent if their only involvement is attending an occasional meeting for the limited purpose of sharing his or her expertise. (Regulation 18239(a)(3).)

The definition of placement agent includes those people who act for compensation "in connection with the offer or sale to a state public retirement system." (Section 82047.3(a).) Your question refers to those people who support the contract after the offer or sale is complete. We understand that new sales might arise at any time, and that a placement agent could present an offer to a public retirement system after obtaining an initial contract. Of course, the placement agent would also have a vested interest in maintaining the public retirement system as a client. Attempting to make an additional sale, or lobbying for retention of a state public retirement system as a client are activities that are "in connection with the offer or sale to a state public retirement system" that is either investment management services or an ownership interest in an investment fund.[6] The placement agent therefore has on-going registration and disclosure requirements in this case. None of this activity, however, converts an employee who is not engaged in an offer or sale with a public retirement system into a placement agent.

If you have other questions on this matter, please contact me at (916) 322-5660.

Sincerely,

Zackery P. Morazzini
General Counsel

By: Heather M. Rowan
Senior Counsel, Legal Division

HMR:jgl

[6] In 2006, the California State Teachers Retirement System ("CalSTRS") adopted a policy requiring all persons connected to an investment sale or investment services contract "to disclose all third party relationships with persons or entities that assisted with the solicitation of CalSTRS as a potential client or the retention of CalSTRS as an existing client." (See Senate Rules Committee AB 1743 analysis, 8/10/10, available here: http://www.leginfo.ca.gov/pub/09-10/bill/asm/ab_1701-1750/ab_1743_cfa_20100818_132053_sen_floor.html.)